

Two Significant Cases Impacting the Oil and Gas Industry in Pennsylvania

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In Pennsylvania, Reed Smith won two recent appellate court decisions for the oil and gas industry. In *Katzin v. Central Appalachia Petroleum, LLC*, No. 135 M.D.A. 2011, 2012 PA Super. 10 (Pa. Super. Ct. Jan. 19, 2012), the Superior Court of Pennsylvania held that a standard royalty provision complied with Pennsylvania's Minimum Royalty Act ("MRA"), even though the provision did not specify what post-production costs may be deducted from the lessor's royalty payments. In *Chesapeake Appalachia, LLC, v. Ginger Golden*, No. 883 C.D. 2011, 2012 Pa. Commw. LEXIS 41 (Pa. Commw. Ct. Jan. 27, 2012), the Commonwealth Court of Pennsylvania held that a county recorder of deeds did not have the authority to set her own policy as to what documents she would record, and instead was required to accept and record all properly acknowledged assignments of multiple oil and gas leases in the form presented by the company.

Katzin v. Central Appalachia Petroleum, LLC

The *Katzin* case provides certainty that standard royalty provisions providing for a one-eighth royalty are valid under Pennsylvania's MRA, even if they do not spell out exactly what post-production costs will be charged to the lessor.

Pennsylvania's MRA provides that an oil and gas lease is invalid if it does not guarantee the lessor at least one-eighth royalty of all oil or natural gas produced. In *Kilmer v. Elexco Land Services, Inc.*, 990 A.2d 1147 (Pa. 2010), the Supreme Court of Pennsylvania held that the net-back method for determining the royalties payable under an oil and gas lease was valid under the MRA. The net-back method allows for the pro-rata deduction of costs associated with post-production activities, such as compression, processing and gathering. The Supreme Court held that a producer could deduct a pro-rata share of all post-production costs from a lessor's royalty and still comply with the Act.

The lease at issue in *Kilmer* specified what post-production costs could be deducted. In *Katzin*, the lessor argued that because his lease failed to specify exactly what post-production costs were going to be deducted from the royalties paid by Chesapeake, the lease failed to comply with *Kilmer* and the MRA. The Pennsylvania Superior Court rejected *Katzin*'s "creative" argument and found that *Katzin*'s lease was valid. The *Katzin* Court found that the fact that the lease contained a one-eighth royalty implied a promise by the parties to comply with the MRA. *Katzin*'s argument that Chesapeake "might" not comply with that implied promise in the calculation of royalties could create a potential breach of contract action but did not invalidate the lease.

The *Katzin* case resulted in the dismissal of two other cases with similar claims, and it may well spell the end of lessor claims of invalidity of leases under the MRA. That case, like *Kilmer*, was brought by lessors attempting to invalidate the leases signed before the discovery of shale plays in Pennsylvania drove up the value of leases. It is clear now, however, that as long as the leases call for a one-eighth royalty, they are valid.

Chesapeake Appalachia, LLC, v. Ginger Golden

In the *Golden* case, the Pennsylvania Commonwealth Court held that a Recorder of Deeds is a ministerial officer with a duty to record documents in the form as prepared by the parties, and is not free to refuse to record documents based on the Recorder's own policies.

Chesapeake attempted to record four assignments of oil and gas leases. The assignments covered a total of 211 leases. Ginger Golden, the Recorder of Deeds in Wayne County, Pennsylvania, refused to record the assignments because of her own policy requiring a separate assignment (and separate filing fee) for each lease assigned. Chesapeake sued for declaratory judgment and mandamus relief. The Wayne County Court of Common Pleas held in favor of Chesapeake and ordered the Recorder to record the multiple lease assignments. The Recorder appealed to the Commonwealth Court.

On appeal, the Recorder acknowledged that assignments of oil and gas leases were documents that she was obligated to record. She also acknowledged that she is not permitted to refuse documents based on their content. She argued, however, that she may reject documents based on their form. She contended that she was required by law to index the assignments against

each lessor and that her computer system would not let her do that unless a separate assignment was submitted for each lease.

The Commonwealth Court rejected the Recorder's arguments and held that she had a duty to record the assignments as they were prepared and submitted by the parties. The Court flatly rejected the Recorder's claim that she was required by law to index assignments as to each lessor. Rather, the law required indexing only as to the "parties" to the assignment – the assignor and assignee. Lessors are not "parties" to an assignment of leases. The Court also rejected the Recorder's argument that Chesapeake was not harmed by her illegal policy because Chesapeake was able to record single-lease assignments. The Court noted that "it goes without saying that filing single lease assignments is not an adequate remedy for a company that has the right to file multiple lease assignments and chooses to do so, but is illegally thwarted in that right."

The *Golden* case should result in greater certainty as to the obligations of recorders of deeds and should result in the recorders striking their policies that conflict with the Golden opinion.

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